

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended.

Local Unit of Government Type <input type="checkbox"/> County <input checked="" type="checkbox"/> City <input type="checkbox"/> Twp <input type="checkbox"/> Village <input type="checkbox"/> Other		Local Unit Name CITY OF REED CITY	County OSCEOLA
Fiscal Year End JUNE 30, 2006	Opinion Date AUGUST 25, 2006	Date Audit Report Submitted to State OCTOBER 20, 2006	

We affirm that:

We are certified public accountants licensed to practice in Michigan.


We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).

YES NO **Check each applicable box below.** (See instructions for further detail.)

1. ☒ ☐ All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary.
2. ☒ ☐ There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures.
3. ☒ ☐ The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury.
4. ☒ ☐ The local unit has adopted a budget for all required funds.
5. ☒ ☐ A public hearing on the budget was held in accordance with State statute.
6. ☒ ☐ The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division.
7. ☒ ☐ The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit.
8. ☒ ☐ The local unit only holds deposits/investments that comply with statutory requirements.
9. ☒ ☐ The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the *Bulletin for Audits of Local Units of Government in Michigan*, as revised (see Appendix H of Bulletin).
10. ☒ ☐ There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover.
11. ☒ ☐ The local unit is free of repeated comments from previous years.
12. ☒ ☐ The audit opinion is UNQUALIFIED.
13. ☒ ☐ The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP).
14. ☒ ☐ The board or council approves all invoices prior to payment as required by charter or statute.
15. ☒ ☐ To our knowledge, bank reconciliations that were reviewed were performed timely.

If a local unit of government (authorities and commissions included) is operating within the boundaries of the audited entity and is not included in this or any other audit report, nor do they obtain a stand-alone audit, please enclose the name(s), address(es), and a description(s) of the authority and/or commission.

I, the undersigned, certify that this statement is complete and accurate in all respects.

We have enclosed the following:	Enclosed	Not Required (enter a brief justification)		
Financial Statements	<input checked="" type="checkbox"/>			
The letter of Comments and Recommendations	<input type="checkbox"/>	NONE NOTED		
Other (Describe)	<input type="checkbox"/>	NONE NOTED		
Certified Public Accountant (Firm Name) REHMANN ROBSON		Telephone Number 616-975-4100		
Street Address 2330 EAST PARIS AVENUE SE		City GRAND RAPIDS	State MI	Zip 49546
Authorizing CPA Signature 		Printed Name Stephen W. Blann, CPA, CGFM		License Number 24801



REED CITY, MICHIGAN

FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2006



REHMANN ROBSON

Certified Public Accountants

CITY OF REED CITY

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CITY OF REED CITY

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REHMANN ROBSON

Certified Public Accountants

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INDEPENDENT AUDITORS' REPORT

August 25, 2006

Honorable Mayor and Members of
the City Council
City of Reed City, Michigan

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Reed City, Michigan, as of and for the year ended June 30, 2006, which collectively comprise the City's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the management of the City of Reed City, Michigan. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information for the City of Reed City, Michigan as of June 30, 2006, and the respective changes in financial position and cash flows, where applicable, thereof and the respective budgetary comparison for the general fund and major streets special revenue fund for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated August 25, 2006, on our consideration of the City of Reed City's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 3-10 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Reed City's basic financial statements. The combining and individual fund financial statements and schedules are presented for purposes of additional analysis and are not a required part of the City of Reed City's basic financial statements. The combining and individual fund financial statements and schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly presented, in all material respects, in relation to the basic financial statements taken as a whole.

A handwritten signature in black ink, reading "Lehmann Johnson". The signature is written in a cursive, flowing style with a large initial 'L'.

Management's Discussion and Analysis

As management of the City of Reed City, we offer readers of the City of Reed City's financial statements this narrative overview and analysis of the financial activities of the City for the fiscal year ended June 30, 2006. We encourage readers to consider the information presented here in conjunction with additional information that is furnished in the financial statements and notes to the financial statements.

Financial Highlights

- The assets of the City of Reed City exceeded its liabilities at the close of the fiscal year by \$11,634,482. Of this amount \$1,048,049 may be used to meet the governments ongoing obligations to citizens and creditors.
- The City's total net assets increased by \$426,936. The increase is attributable to the increase in Capital Assets of Governmental Activities due to the new Police Station and the Old 131 Turnback Project.
- As of the close of the fiscal year the City of Reed City's governmental funds reported combined ending fund balances of \$1,029,722 a decrease of \$65,524 in comparison with the prior year. Approximately 79% of the total fund balance, \$815,485 is available for spending at the government's discretion. (These amounts include the undesignated fund balance for the General, Special Revenue, Capital Projects, and Permanent Funds).
- At the end of the fiscal year unreserved fund balance for the general fund was \$254,855 or 22 percent of total general fund expenditures.
- The City's total debt decreased by \$173,696 (7.6%) from the previous fiscal year.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the City of Reed City's financial statements. The City's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

Government-wide financial statements. The *government-wide financial statements* are designed to provide readers with a broad overview of the City's finances, in a manner similar to a private-sector business.

The *statement of net assets* presents information on all of the City's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.

The *statement of activities* presents information showing how the government's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related cash flows*. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., earned but unused compensated absences).

Both of the government-wide financial statements distinguish functions of the City of Reed City that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all or a significant portion of their costs through user fees and charges (*business-type activities*). The governmental activities of the City include general government administration, police, public works including major and local street maintenance and recreation and cultural activities. The business-type activities of the City include sewer and water services.

The government-wide financial statements can be found on pages 11-13 of this report.

Fund financial statements. A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City of Reed City, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the City can be divided into three categories: governmental funds, proprietary funds, and fiduciary funds.

Governmental funds. *Governmental funds* are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on *near-term inflows and outflows of spendable resources*, as well as on *balances of spendable resources* available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

The City maintains sixteen individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the following three funds: General, Major Street, and Police Building.

Data is combined into a single aggregated presentation for the other thirteen governmental funds. Individual fund data for each of the non-major governmental funds is provided in the form of *combining statements and schedules*.

The City adopts an annual appropriated budget for its general, special revenue funds, and other funds as necessary. Budgetary comparison statements or schedules have been provided herein to demonstrate compliance with those budgets.

The basic governmental fund financial statements can be found on pages 14-19 of this report.

Proprietary funds. The City maintains two different types of proprietary funds. *Enterprise funds* are used to report the same functions presented as *business-type activities* in the government-wide financial statements. The City uses enterprise funds to account for its Sewer and Water operations. *Internal service funds* are an accounting device used to accumulate and allocate costs internally among the City's various functions. The City uses the internal service fund to account for its fleet of vehicles and accounting for compensated absences. Because these services predominantly benefit governmental rather than business-type functions, they have been included within *governmental activities* in the government-wide financial statements.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail. The proprietary fund financial statements provide information for the Sewer and Water operations, which is considered to be a major fund of the City.

The basic proprietary fund financial statements can be found on pages 20-22 of this report.

Fiduciary funds. Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are *not* reflected in the government-wide financial statement because the resource of those funds are *not* available to the support the City's own programs. The accounting used for fiduciary funds is much like that used for proprietary funds.

The fiduciary fund financial statements can be found on page 23 of this report.

Notes to the financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 24-38 of this report.

Other information. In addition to the basic financial statements and accompanying notes, this report also presents certain *required supplementary information*. This includes this management discussion and analysis as well as schedules of funding progress and employer contributions related to the City's pension plan which can be found in Note 8 on pages 34 and 35 of this report.

Combining and individual fund statements and schedules can be found on pages 43-54 of this report.

Government-wide Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the City of Reed City, assets exceeded liabilities by \$11,634,482 at the close of the most recent fiscal year.

A little less than 10% of the City's net assets reflects unrestricted net assets which are available for future operation while a significant portion (82.9%) of net assets is invested in capital assets (e.g., land, buildings, vehicles, equipment and infrastructure), less any related debt used to acquire those assets that is still outstanding. The City uses these capital assets to provide services to citizens; consequently, these assets are *not* available for future spending. Although the City investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

City of Reed City Net Assets

	Governmental Activities		Business-type Activities		Total	
	2005	2006	2005	2006	2005	2006
Current and other assets	\$1,386,313	\$1,280,563	\$1,179,164	\$1,027,864	\$ 2,565,477	\$ 2,308,427
Capital assets	2,489,131	2,983,515	8,665,731	8,745,628	11,154,862	11,729,143
Total assets	3,875,444	4,264,078	9,844,895	9,773,492	13,720,339	14,037,570
Long-term liabilities						
outstanding	724,474	689,026	1,462,683	1,324,979	2,187,157	2,014,005
Other liabilities	162,950	145,703	162,686	243,380	325,636	389,083
Total liabilities	887,424	834,729	1,625,369	1,568,359	2,512,793	2,403,088
Net assets:						
Invested in capital assets, net of related debt	1,768,181	2,299,515	7,136,749	7,347,944	8,904,930	9,647,459
Restricted	328,643	570,131	347,509	368,843	676,152	938,974
Unrestricted	891,196	559,703	735,268	488,346	1,626,464	1,048,049
Total net assets	<u>\$2,988,020</u>	<u>\$3,429,349</u>	<u>\$8,219,526</u>	<u>\$8,205,133</u>	<u>\$11,207,546</u>	<u>\$11,634,482</u>

Net assets of the City increased by \$426,936 with the governmental activities showing additions to prior balances. The business-type activities decrease in net assets of \$14,393 was primarily the result of depreciation expensed as a part of operations. The governmental activities increase in net assets of \$441,329 is primarily due to the Police Station and Old 131 Turnback improvements.

City of Reed City Changes in Net Assets

	Governmental Activities		Business-type Activities		Total	
	2005	2006	2005	2006	2005	2006
Revenue						
Program Revenue						
Charges for services	\$ 198,903	\$ 204,004	\$1,472,372	\$1,495,661	\$1,671,275	\$1,699,665
Operating grants and contributions	139,874	154,624	-	45,857	139,874	200,481
Capital grant and contributions	291,947	378,641	-	-	291,947	378,641
	630,724	737,269	1,472,372	1,541,518	2,103,096	2,278,787
General revenue						
Property taxes	604,367	616,373	-	-	604,367	616,373
Other governmental sources	492,136	510,700			492,136	510,700
Other	294,367	231,865	15,341	29,609	309,708	261,474
Total revenue	<u>2,021,594</u>	<u>2,096,207</u>	<u>1,487,713</u>	<u>1,571,127</u>	<u>3,509,307</u>	<u>3,667,334</u>

City of Reed City Changes in Net Assets (Continued)

	Governmental Activities		Business-type Activities		Total	
	2005	2006	2005	2006	2005	2006
Expenses						
General Government	\$ 541,231	\$ 471,076	\$ -	\$ -	\$ 541,231	\$ 471,076
Public Safety	405,139	502,771	-	-	405,139	502,771
Highways and Streets	240,679	228,145	-	-	240,679	228,145
Public works	170,556	179,076	-	-	170,556	179,076
Culture and recreation	233,692	242,433	-	-	233,692	242,433
Interest	30,183	31,377	-	-	30,183	31,377
Water & Sewer	-	-	1,505,753	1,585,520	1,505,753	1,585,520
Total expenses	1,621,480	1,654,878	1,505,753	1,585,520	3,127,233	3,240,398
Change in net assets	400,114	441,329	(18,040)	(14,393)	382,074	426,936
Net assets - beginning of year	2,587,906	2,988,020	8,237,566	8,219,526	10,825,472	11,207,546
Net assets - end of year	\$2,988,020	\$3,429,349	\$8,219,526	\$8,205,133	\$11,207,546	\$11,634,482

The Operating grants and Contributions figure includes penal fines for the Library and Township fire contracts for the Fire Department.

The amounts in Other Governmental Sources includes State Revenue Sharing, Act 51 Gas Tax funds and contributions from the Downtown Development Authority (DDA).

Governmental activities. During the year the City continued its emphasis in public safety by investing \$502,771 or 30% of governmental activities expenses. Culture and recreation, which includes library operations was \$242,433 or 15% of governmental activities expenses while general government, public works and streets and interest on long-term debt made up the remaining 55% of governmental activities expenses.

The Governmental activities represented above included Police Department and Fire Department operations, Department of Public Works, Library, Major Streets, and Administrative functions.

Business-type activities. Although the net assets decreased by \$14,393 this amount is less than the previous fiscal year decrease of \$18,040. These activities included Water and Sewer operations and the Equipment Pool.

Financial Analysis of the Government's Funds

As noted earlier, the City uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental funds. The focus of the City's *governmental funds* is to provide information on near-term inflows, outflows, and balances of *spendable* resources. Such information is useful in assessing the City's financing requirements. In particular, *unreserved fund balance* may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As of the end of the current fiscal year, the City's governmental funds reported combined ending fund balances of \$1,029,722, a decrease of \$65,524 in comparison with the prior year. The general fund is the chief operating fund of the City. At the end of the current fiscal year, unreserved fund balance of the general fund was \$254,855. As a measure of the general fund's liquidity, it may be useful to compare unreserved fund balance to total fund expenditures. Unreserved fund balance represents 22 percent of total general fund expenditures. The City Council's annual target is 25 percent of total general fund expenditures.

The fund balance of the City's general fund decreased by \$12,161 during the current fiscal year which was considerably less than the budgeted decrease of \$41,216.

The major street fund has a total fund balance of \$82,249, which decreased by \$66,419 during the year.

Proprietary funds. The City's proprietary funds provide the same type of information found in the government wide financial statements, but in more detail.

Unrestricted net assets of the sewer and water fund at the end of the year amounted to \$488,346. The fund had a decrease in net assets for the year of \$14,393. Factors concerning the finances of the fund have already been addressed in the discussion of the City's business-type activities.

General Fund Budgetary Highlights

Differences between the final and amended budgets for expenditures amounted to 8.9% for the year. Most of the difference is attributed to decreases in expenditures.

During the year, general fund revenues were less than budgetary estimates and expenditures were also less. An actual decrease in fund balance resulted that was less than the final amended budget amount by \$29,055.

Capital Asset and Debt Administration

Capital assets. The City's investment in capital assets for its governmental and business type activities as of June 30, 2006, amounted to \$11,729,143 (net of accumulated depreciation). This investment in capital assets includes land, buildings and improvements, furniture and equipment, motor pool equipment, motor vehicles, infrastructure and construction in progress, machinery and equipment. Significant capital assets acquired during the year consisted primarily the Police Station and 131 Turnback.

The total increase in the City's investment in capital assets for the 2006 fiscal year was 5.4% (a 20% increase for governmental activities and a 1% increase for business-type activities).

City of Reed City Capital Assets
(net of depreciation)

	Governmental Activities		Business-type Activities		Total	
	2005	2006	2005	2006	2005	2006
Land	\$ 92,611	\$ 93,104	\$ 30,305	\$ 30,305	\$ 122,916	\$ 123,409
Land improvements	102,463	74,238	-	-	102,463	74,238
Buildings and improvements	1,291,930	1,642,186	9,537	10,417	1,301,467	1,652,603
Furniture and equipment	189,445	182,709	167,624	177,510	357,069	360,219
Motor vehicles	304,337	303,579	-	-	304,337	303,579
Infrastructure	470,369	683,011	-	-	470,369	683,011
Water System	-	-	460,194	663,636	460,194	663,636
Sewer System	-	-	7,974,173	7,720,643	7,974,173	7,720,643
Construction in progress	37,976	4,688	23,898	143,117	61,874	147,805
Total	\$2,489,131	\$2,983,515	\$8,665,731	\$8,745,628	\$11,154,862	\$11,729,143

Additional information on the City of Reed City's capital assets can be found in Note 7 on pages 33 and 34 of this report.

Long-term debt. At the end of the current fiscal year, the City had total debt outstanding of \$2,116,710 as follows:

	Governmental Activities		Business-type Activities		Total	
	2005	2006	2005	2006	2005	2006
General obligation bonds	\$549,000	\$539,000	\$ -	\$ -	\$ 549,000	\$ 539,000
Special assessment with government commitment	165,000	145,000	-	-	165,000	145,000
Installment notes	6,950	-	273,982	247,684	280,932	247,684
Revenue bonds	-	-	1,255,000	1,150,000	1,255,000	1,150,000
Long-term compensated absences	40,474	35,026	-	-	40,474	35,026
Total	\$761,424	\$719,026	\$1,528,982	\$1,397,684	\$2,290,406	\$2,116,710

The City's total debt decreased by \$173,696 during the current fiscal year.

Additional information on the City's long-term debt can be found in Note 9 on pages 35 and 36 of this report.

Economic Factors and Next Year's Budgets and Rates

The following factors were considered in preparing the City's budget for the 2006-07 fiscal year:

- Increased employee wages and benefit cost.
- Increased health insurance cost with the prospect that costs can be reduced through a negotiated benefit change.
- Limited increased property tax revenue.
- Stable water and sewer revenues.
- No change in state revenue sharing payments.

Requests for Information

This financial report is designed to provide a general overview of the City's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the City Treasurer, 227 East Lincoln Avenue, Reed City, Michigan, 49677.

CITY OF REED CITY

Statement of Net Assets

June 30, 2006

	Primary Government			Component Unit
	Governmental	Business-type		Downtown Development Authority
	Activities	Activities	Total	
Assets				
Cash and cash equivalents	\$1,030,822	\$ 370,197	\$ 1,401,019	\$ 460,374
Accounts receivable, net of allowance	146,710	186,959	333,669	35,816
Special assessment receivable	88,955	-	88,955	-
Prepaid items and other assets	14,076	3,706	17,782	-
Inventory	-	4,809	4,809	-
Restricted cash and cash equivalents	-	413,843	413,843	-
Bond issuance costs net of accumulated amortization	-	48,350	48,350	-
Capital assets:				
Land	93,104	30,305	123,409	-
Construction in progress	4,688	143,117	147,805	-
Buildings, equipment and fixtures, net	2,885,723	8,572,206	11,457,929	-
Total assets	4,264,078	9,773,492	14,037,570	496,190
Liabilities				
Accounts payable	44,192	101,065	145,257	2,605
Accrued liabilities	71,511	66,834	138,345	5,020
Unearned revenue	-	2,776	2,776	-
Noncurrent liabilities:				
Due within one year	30,000	72,705	102,705	40,000
Due in more than one year	689,026	1,324,979	2,014,005	1,060,000
Total liabilities	834,729	1,568,359	2,403,088	1,107,625
Net assets				
Invested in capital assets, net of related debt	2,299,515	7,347,944	9,647,459	-
Restricted for:				
Highways and Streets	106,436	-	106,436	-
Capital Projects	21,321	-	21,321	-
Public Safety	75,383	-	75,383	-
Debt Service	87,481	368,843	456,324	-
Recreation and culture	146,186	-	146,186	-
Other purposes	88,978	-	88,978	-
Nonexpendable perpetual trust:				
Cemetery - expendable portion	10,596	-	10,596	-
Cemetery - corpus	33,750	-	33,750	-
Unrestricted (deficit)	559,703	488,346	1,048,049	(611,435)
Total net assets (deficit)	\$3,429,349	\$8,205,133	\$ 11,634,482	\$ (611,435)

The accompanying notes are an integral part of these financial statements.

CITY OF REED CITY

Statement of Activities

For the Year Ended June 30, 2006

<u>Functions / Programs</u>	<u>Expenses</u>	<u>Program Revenues</u>			<u>Net (Expense) Revenue</u>
		<u>Charges for Services</u>	<u>Operating Grants and Contributions</u>	<u>Capital Grants and Contributions</u>	
Primary government					
Governmental activities:					
General government	\$ 471,076	\$ 185,617	\$ 930	\$ -	\$ (284,529)
Public safety	502,771	240	65,448	378,641	(58,442)
Highways and streets	228,145	-	-	-	(228,145)
Recreation and culture	242,433	3,797	88,246	-	(150,390)
Public works	179,076	14,350	-	-	(164,726)
Interest on long-term debt	31,377	-	-	-	(31,377)
Total governmental activities	<u>1,654,878</u>	<u>204,004</u>	<u>154,624</u>	<u>378,641</u>	<u>(917,609)</u>
Business-type activities:					
Water and sewer	<u>1,585,520</u>	<u>1,495,661</u>	<u>45,857</u>	<u>-</u>	<u>(44,002)</u>
Total primary government	<u>\$ 3,240,398</u>	<u>\$ 1,699,665</u>	<u>\$ 200,481</u>	<u>\$ 378,641</u>	<u>\$ (961,611)</u>
Component unit					
Downtown Development Authority	<u>\$ 818,269</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (818,269)</u>

(Continued)

The accompanying notes are an integral part of these financial statements.

CITY OF REED CITY

Statement of Activities (Concluded)

For the Year Ended June 30, 2006

	Primary Government			Component Unit
	Governmental Activities	Business-type Activities	Total	Downtown Development Authority
Changes in net assets				
Net (expense) revenue	\$ (917,609)	\$ (44,002)	\$ (961,611)	\$ (818,269)
General revenues:				
Property taxes	616,373	-	616,373	551,785
State shared revenues	510,700	-	510,700	-
Local sources	40,609	-	40,609	-
Gain on sale of capital assets	1,031	526	1,557	-
Interest earnings	52,025	31,083	83,108	23,863
Other general revenues	136,200	-	136,200	-
Transfers - internal activities	2,000	(2,000)	-	-
Total general revenues and transfers	1,358,938	29,609	1,388,547	575,648
Change in net assets	441,329	(14,393)	426,936	(242,621)
Net assets (deficit), beginning of year	2,988,020	8,219,526	11,207,546	(368,814)
Net assets (deficit), end of year	\$ 3,429,349	\$ 8,205,133	\$ 11,634,482	\$ (611,435)
				(Concluded)

The accompanying notes are an integral part of these financial statements.

CITY OF REED CITY

Balance Sheet Governmental Funds

June 30, 2006

	General Fund	Major Streets	Police Building	Other Governmental Funds	Total Governmental Funds
Assets					
Cash and cash equivalents	\$ 218,277	\$ 61,955	\$ 165	\$ 668,729	\$ 949,126
Accounts receivable	25,162	-	-	337	25,499
Special assessments receivable	-	-	-	88,955	88,955
Due from other governmental units	89,110	24,318	-	7,783	121,211
Prepaid items	12,059	396	-	1,211	13,666
 Total assets	 \$ 344,608	 \$ 86,669	 \$ 165	 \$ 767,015	 \$ 1,198,457
Liabilities and Fund Balances					
Liabilities					
Accounts payable	\$ 27,338	\$ 631	\$ -	\$ 11,255	\$ 39,224
Accrued liabilities	13,307	638	-	2,002	15,947
Due to other funds	37,049	3,151	-	1,812	42,012
Deferred revenue	-	-	-	71,552	71,552
 Total liabilities	 77,694	 4,420	 -	 86,621	 168,735
Fund balances					
Reserved for:					
Prepaid items	12,059	396	-	1,211	13,666
Cemetery perpetual care	-	-	-	33,750	33,750
Unreserved:					
Designated for subsequent year expenditures	26,751	4,400	-	42,115	73,266
Undesignated	228,104	77,453	165	-	305,722
Undesignated, reported in nonmajor:					
Special Revenue Funds	-	-	-	478,011	478,011
Debt Service Funds	-	-	-	93,555	93,555
Capital Project Funds	-	-	-	21,156	21,156
Permanent Fund	-	-	-	10,596	10,596
 Total fund balances	 266,914	 82,249	 165	 680,394	 1,029,722
 Total liabilities and fund balances	 \$ 344,608	 \$ 86,669	 \$ 165	 \$ 767,015	 \$ 1,198,457

The accompanying notes are an integral part of these financial statements.

CITY OF REED CITY

Reconciliation of Fund Balances on the Balance Sheet for Governmental Funds to Net Assets of Governmental Activities on the Statement of Net Assets

June 30, 2006

Fund balances - total governmental funds	\$ 1,029,722
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Amounts reported for *governmental activities* in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources, and therefore are not reported in the fund statements.

Add - land	93,104
Add - construction in progress	4,688
Add - capital assets, net of accumulated depreciation	2,885,723

Certain assets, such as special assessments receivable are not due and receivable in the current period and therefore are offset with deferred revenue in the fund statements.

Add - deferred revenue on special assessments receivable	71,552
--	--------

An internal service fund is used by management to charge the costs of certain activities, such as insurance and other centralized costs, to individual funds. The assets and liabilities of the internal service fund is included in governmental activities.

Add - net assets of governmental activities accounted for in the internal service fund	328,442
Deduct - Capital assets accounted for in the internal service fund, net of accumulated depreciation	(258,782)

Certain liabilities, such as bonds payable, are not due and payable in the current period, and therefore are not reported in the fund statements:

Deduct - bonds payable	(684,000)
Deduct - compensated absences	(35,026)
Deduct - accrued interest on long-term liabilities	(6,074)

Net assets of governmental activities	<u>\$ 3,429,349</u>
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The accompanying notes are an integral part of these financial statements.

CITY OF REED CITY

Statement of Revenues, Expenditures and Changes in Fund Balances Governmental Funds

For the Year Ended June 30, 2006

	General Fund	Major Streets	Police Building	Other Governmental Funds	Total Governmental Funds
Revenues					
Taxes	\$ 551,334	\$ -	\$ -	\$ 65,039	\$ 616,373
Licenses and permits	20,864	-	-	-	20,864
Intergovernmental revenue					
State	269,065	183,694	-	55,933	508,692
Local	33,609	-	358,641	27,000	419,250
Charges for services	120,564	-	-	-	120,564
Fines	6,240	-	-	-	6,240
Special assessments	-	-	-	22,616	22,616
Miscellaneous	168,882	103,302	1	126,377	398,562
Total revenues	1,170,558	286,996	358,642	296,965	2,113,161
Expenditures					
Current:					
Legislative	24,837	-	-	-	24,837
General government	306,328	-	-	391	306,719
Public safety	457,232	-	-	1,059	458,291
Public works	176,472	137,951	-	90,194	404,617
Culture and recreation	70,865	-	-	114,212	185,077
Other governmental functions	134,822	-	-	-	134,822
Debt service:					
Principal	-	-	-	30,000	30,000
Interest	-	-	-	31,661	31,661
Capital outlay	10,632	201,585	358,477	34,967	605,661
Total expenditures	1,181,188	339,536	358,477	302,484	2,181,685
Revenues over (under) expenditures	(10,630)	(52,540)	165	(5,519)	(68,524)
Other financing sources (uses)					
Transfers in	5,000	8,343	-	62,497	75,840
Transfers out	(6,531)	(22,222)	-	(44,087)	(72,840)
Total other financing sources (uses)	(1,531)	(13,879)	-	18,410	3,000
Net changes in fund balances	(12,161)	(66,419)	165	12,891	(65,524)
Fund balances, beginning of year	279,075	148,668	-	667,503	1,095,246
Fund balances, end of year	\$ 266,914	\$ 82,249	\$ 165	\$ 680,394	\$ 1,029,722

The accompanying notes are an integral part of these financial statements.

CITY OF REED CITY

Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances of Governmental Funds to the Statement of Activities

For the Year Ended June 30, 2006

Net changes in fund balances - total governmental funds	\$ (65,524)
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Amounts reported for *governmental activities* in the statement of activities are different because:

Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.

Add - capital outlay	589,258
Deduct - depreciation expense	(99,156)

Special assessments receivable are long-term in nature and are collectable over several years. However, the current receipts are reflected as revenues on the fund statements

Deduct - decrease in deferred long-term receivables	(22,616)
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Bond proceeds provide current financial resources to governmental funds in the period issued, but issuing bonds increases long-term liabilities in the statement of net assets. Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets

Add - principal payments on long-term liabilities	30,000
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Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.

Add - decrease in accrued interest on bonds	365
Add - decrease in the accrual for compensated absences	5,448

An internal service fund is used by management to charge the costs of certain services to individual governmental funds. The net revenue (expense) attributable to those funds is reported with governmental activities.

Add - income from governmental activities in internal service fund	3,554
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Change in net assets of governmental activities	<u>\$ 441,329</u>
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The accompanying notes are an integral part of these financial statements.

CITY OF REED CITY

Statement of Revenues, Expenditures and Change in Fund Balance Budget and Actual General Fund

For the Year Ended June 30, 2006

	Original Budget	Amended Budget	Actual	Actual Over (Under) Budget
Revenues				
Taxes	\$ 547,750	\$ 547,750	\$ 551,334	\$ 3,584
Licenses and permits	20,150	20,150	20,864	714
Intergovernmental revenues:				
State	275,494	276,844	269,065	(7,779)
Local	26,400	107,215	33,609	(73,606)
Charges for services	101,080	121,146	120,564	(582)
Fines and forfeits	3,450	6,150	6,240	90
Miscellaneous	158,535	168,035	168,882	847
Total revenues	1,132,859	1,247,290	1,170,558	(76,732)
Expenditures				
Current:				
Legislative	24,453	26,403	24,837	(1,566)
General government	316,354	321,459	306,328	(15,131)
Public safety	455,367	470,622	457,232	(13,390)
Public works	176,048	179,033	176,472	(2,561)
Culture and recreation	60,923	73,975	70,865	(3,110)
Other governmental functions	134,090	138,590	134,822	(3,768)
Capital outlay	21,825	86,893	10,632	(76,261)
Total expenditures	1,189,060	1,296,975	1,181,188	(115,787)
Revenues over (under) expenditures	(56,201)	(49,685)	(10,630)	39,055
Other financing sources (uses)				
Transfers in	29,450	15,000	5,000	(10,000)
Transfers (out)	-	(6,531)	(6,531)	-
Total other financing sources (uses)	29,450	8,469	(1,531)	(10,000)
Net change in fund balance	(26,751)	(41,216)	(12,161)	29,055
Fund balance, beginning of year	279,075	279,075	279,075	-
Fund balance, end of year	\$ 252,324	\$ 237,859	\$ 266,914	\$ 29,055

The accompanying notes are an integral part of these financial statements.

CITY OF REED CITY

**Statement of Revenues, Expenditures
and Changes in Fund Balance
Budget and Actual
Major Streets Fund**

For the Year Ended June 30, 2006

	Original Budget	Amended Budget	Actual	Actual Over (Under) Budget
Revenues				
Intergovernmental revenues:				
State	\$ 166,126	\$ 185,613	\$ 183,694	\$ (1,919)
Miscellaneous	231,468	170,898	103,302	(67,596)
Total revenues	397,594	356,511	286,996	(69,515)
Expenditures				
Highways and streets	389,522	144,959	137,951	(7,008)
Capital outlay	-	202,403	201,585	(818)
Total expenditures	389,522	347,362	339,536	(7,826)
Revenues over (under) expenditures	8,072	9,149	(52,540)	(61,689)
Other financing sources (uses)				
Transfers in	9,750	9,750	8,343	(1,407)
Transfers (out)	(22,222)	(22,222)	(22,222)	-
Total other financing sources (uses)	(12,472)	(12,472)	(13,879)	(1,407)
Net change in fund balance	(4,400)	(3,323)	(66,419)	(63,096)
Fund balance, beginning of year	148,668	148,668	148,668	-
Fund balance, end of year	\$ 144,268	\$ 145,345	\$ 82,249	\$ (63,096)

The accompanying notes are an integral part of these financial statements.

CITY OF REED CITY

Statement of Net Assets Proprietary Funds

June 30, 2006

	Business-Type Activities Sewer & Water Enterprise Fund	Governmental Activities Internal Service Funds
Assets		
Current assets:		
Cash and cash equivalents	\$ 370,197	\$ 81,696
Accounts receivable, net of allowance	186,959	-
Inventory	4,809	-
Bond issuance costs net of accumulated amortization	48,350	-
Due from other funds	-	42,012
Prepaid items	3,706	410
Restricted cash and cash equivalents	413,843	-
	<hr/>	<hr/>
Total current assets	1,027,864	124,118
	<hr/>	<hr/>
Non-current assets:		
Capital assets:		
Land	30,305	-
Construction in progress	143,117	-
Property, plant and equipment	12,775,364	-
Machinery and equipment	-	721,547
	<hr/>	<hr/>
Less: accumulated depreciation	(4,203,158)	(462,765)
	<hr/>	<hr/>
Total non-current assets	8,745,628	258,782
	<hr/>	<hr/>
Total assets	9,773,492	382,900
	<hr/>	<hr/>
Liabilities		
Current liabilities:		
Accounts payable	101,065	4,968
Accrued liabilities	66,834	49,490
Unearned revenue	2,776	-
Current maturity of notes payable	27,705	-
Current maturity of bonds payable, payable from restricted assets	45,000	-
	<hr/>	<hr/>
Total current liabilities	243,380	54,458
	<hr/>	<hr/>
Noncurrent liabilities:		
Bonds and notes payable, net of current maturities	1,324,979	-
	<hr/>	<hr/>
Total liabilities	1,568,359	54,458
	<hr/>	<hr/>
Net assets		
Invested in capital assets, net of related debt	7,347,944	258,782
Restricted for debt service	368,843	-
Unrestricted	488,346	69,660
	<hr/>	<hr/>
Total net assets	\$ 8,205,133	\$ 328,442
	<hr/>	<hr/>

The accompanying notes are an integral part of these financial statements.

CITY OF REED CITY

Statement of Revenues, Expenses and Changes in Net Assets Proprietary Funds

For the Year Ended June 30, 2006

	Business-Type Activities	Governmental Activities
	Sewer & Water Enterprise Fund	Internal Service Funds
Operating revenues		
Charges for services	\$ 1,407,021	\$ 178,087
Miscellaneous	134,497	856
	<hr/>	<hr/>
Total operating revenues	1,541,518	178,943
	<hr/>	<hr/>
Operating expenses		
Personnel services	454,100	56,262
Contractual services	199,531	15,728
Materials and supplies	113,755	33,280
Utilities	266,278	9,952
Repairs and maintenance	54,508	20,524
Lease and rental	25,009	-
Depreciation and amortization	340,011	42,224
Miscellaneous	63,888	-
	<hr/>	<hr/>
Total operating expenses	1,517,080	177,970
	<hr/>	<hr/>
Operating income	24,438	973
	<hr/>	<hr/>
Non-operating revenues (expenses)		
Gain on sale of capital assets	526	1,031
Interest income	31,083	2,631
Interest expense	(68,440)	(81)
	<hr/>	<hr/>
Total non-operating revenues (expenses)	(36,831)	3,581
	<hr/>	<hr/>
Net income (loss) before transfers	(12,393)	4,554
	<hr/>	<hr/>
Transfers		
Transfers out	(2,000)	(1,000)
	<hr/>	<hr/>
Change in net assets	(14,393)	3,554
	<hr/>	<hr/>
Net assets, beginning of year	8,219,526	324,888
	<hr/>	<hr/>
Net assets, end of year	<u>\$ 8,205,133</u>	<u>\$ 328,442</u>

The accompanying notes are an integral part of these financial statements.

CITY OF REED CITY

**Statement of Cash Flows
Proprietary Funds**

For the Year Ended June 30, 2006

	Business-Type Activities Sewer & Water Enterprise Fund	Governmental Activities Internal Service Funds
Cash flows from operating activities		
Receipts from interfund services provided	\$ -	\$ 220,955
Receipts from customers and users	1,556,670	-
Payments to suppliers	(654,528)	(77,326)
Payments to employees	(451,115)	(56,498)
	<hr/>	<hr/>
Net cash provided by operating activities	451,027	87,131
Cash flows from non-capital financing activities		
Amounts lent to other funds	-	(42,012)
Transfers (out)	(2,000)	(1,000)
	<hr/>	<hr/>
Net cash provided by (used in) non-capital financing activities	(2,000)	(43,012)
Cash flows from capital and related financing activities		
Acquisition of capital assets	(416,937)	(46,506)
Proceeds from sale of capital assets	525	1,031
Principal paid on bonds	(131,298)	(6,950)
Interest and fiscal charges paid	(68,440)	(81)
	<hr/>	<hr/>
Net cash provided by (used in) capital and related financing activities	(616,150)	(52,506)
Cash flows from investing activities		
Interest earned on investments	31,083	2,631
	<hr/>	<hr/>
Net increase (decrease) in cash and cash equivalents	(136,040)	(5,756)
Cash and cash equivalents, beginning of year	920,080	87,452
	<hr/>	<hr/>
Cash and cash equivalents, end of year	\$ 784,040	\$ 81,696
	<hr/>	<hr/>
Cash and cash equivalents per the statement of net assets		
Cash and cash equivalents	\$ 370,197	\$ 81,696
Restricted cash and cash equivalents	413,843	-
	<hr/>	<hr/>
	\$ 784,040	\$ 81,696
	<hr/>	<hr/>
Cash flows from operating activities		
Operating income	\$ 24,438	\$ 973
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	340,011	42,224
Changes in operating assets and liabilities which provided (used) cash:		
Accounts receivable	12,663	-
Inventory	(84)	-
Prepaid items	(289)	(48)
Accounts payable	68,814	2,206
Accrued liabilities	2,985	41,776
Deferred revenue	2,489	-
	<hr/>	<hr/>
Net cash provided by operating activities	\$ 451,027	\$ 87,131
	<hr/>	<hr/>

The accompanying notes are an integral part of these financial statements.

CITY OF REED CITY

Fiduciary Funds Statement of Assets and Liabilities

June 30, 2006

	Agency Funds
	<hr/>
Assets	
Cash and cash equivalents	<u><u>\$ 13,887</u></u>
Liabilities	
Accounts payable	\$ 1,295
Due to other governmental units	1,758
Deposits held for others	<u>10,834</u>
Total liabilities	<u><u>\$ 13,887</u></u>

The accompanying notes are an integral part of these financial statements.

CITY OF REED CITY

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2006

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the City of Reed City conform to generally accepted accounting principles as applicable to governments. The following is a summary of the most significant policies:

The Reporting Entity

As required by generally accepted accounting principles, these financial statements present the City and its component unit, an entity for which the City is considered to be financially accountable. Blended component units, although legally separate entities are, in substance, part of the City's operations, so data from these units are combined with data of the primary government. The City has no blended component units. Discretely presented component units are reported in a separate column in the financial statements to emphasize they are legally separate from the City.

Discretely Presented Component Unit

The component unit column in the basic financial statements include the financial data of the Downtown Development Authority. This unit is reported in a separate column and rows to emphasize that it is legally separate from the City.

The members of the governing board of the Authority are appointed by the City Council. The budgets of the Authority must be approved by the City Council, and the City has the ability to significantly influence its operations. Financial statements are not separately issued for the component unit.

Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the nonfiduciary activities of the primary government and its component unit. For the most part, the effect of interfund activity has been removed from these statements. *Governmental activities*, which normally are supported by taxes and intergovernmental revenues, are reported separately from *business-type activities*, which rely to a significant extent on fees and charges for support.

Likewise, the *primary government* is reported separately from the *component unit* for which the primary government is financially accountable.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. *Direct expenses* are those that are clearly identifiable with a specific function or segment. *Program revenues* include (1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and (2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as *general revenues*.

CITY OF REED CITY

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2006

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds, even though the latter are excluded from the government-wide financial statements. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements.

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The government-wide financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*, as are the proprietary fund and fiduciary fund financial statements, except for agency funds, which do not have a measurement focus. Revenues are recorded when earned and expenses are recorded when the liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. After March 1 of each year, the County pays the City, and is responsible for collecting, any outstanding real property taxes as of that date. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Governmental fund financial statements are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures are recorded only when payment is due.

Property taxes, intergovernmental revenue, charges for services and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. Only the portion of special assessments receivable due within the current fiscal period is considered to be susceptible to accrual as revenue of the current period. All other revenue items are considered to be measurable and available only when cash is received by the City.

The City reports the following major governmental funds:

The *General Fund* is the City's primary operating fund. It accounts for all the financial resources of the general government, except those required to be accounted for in another fund.

The *Major Streets Special Revenue Fund* is used to account for motor fuel tax revenue which is restricted for maintenance and construction of major streets.

The *Police Building Capital Projects Fund* accounts for the revenues and expenditures associated with the police building construction project.

CITY OF REED CITY
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2006

The City reports the following major proprietary fund:

The *Sewer and Water Enterprise Fund* is used to account for the operations of the City's sewer and water department that provides sewer and water services to most residents of the City on a user charge basis.

Additionally, the City reports the following fund types:

The *Special Revenue Funds* are used to account for proceeds from specific revenue sources (other than perpetual trusts or capital projects) and related expenditures which are restricted for specific purposes by administrative action or law.

The *Debt Service Funds* account for the resources accumulated and payments made for principal and interest on long-term debt of governmental funds.

The *Capital Projects Funds* are used to account for the accumulation and disbursement of funds for capital projects.

The *Permanent Fund* is used to account for resources that are legally restricted to the extent that only earnings, and not principal may be used for purposes that support the City programs.

The *Internal Service Funds* accounts for equipment and vehicle purchases, repairs and maintenance, and charges to compensated absences provided to the City departments on a cost reimbursement basis.

The *Agency Funds* are used to account for assets held in an agency capacity on behalf of outside parties, including other governments.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989 generally are followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to this same limitation. The government has elected not to follow subsequent private-sector guidance.

Proprietary funds distinguish *operating* revenues and expenses from *nonoperating* items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the enterprise fund are charges for services. The principal operating revenues of the City's internal service funds are charges to City departments for equipment utilization and insurance coverage. Operating expenses for the enterprise funds include depreciation on capital assets, labor, supplies and contracted services. Operating expenses for the internal funds include the cost of services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

When both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first, then unrestricted resources as they are needed.

CITY OF REED CITY
NOTES TO FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2006

Budgets and Budgetary Accounting

Comparisons to budget are presented for General and Special Revenue Funds. General and Special Revenue Funds adopt a legal budget with remaining funds maintaining budgets as a management control device. The City follows these procedures in establishing the budgetary data reflected in the financial statements:

1. Prior to May 1, the City Manager submits to the City Council a proposed operating budget for the fiscal year commencing the following July 1.
2. Public hearings are conducted to obtain taxpayer comments.
3. By the second week of May the budget is legally enacted through passage of a resolution.
4. Formal budgetary integration is employed for the government fund types as a management control device.
5. Budgets for the General and Special Revenue Funds are adopted on a basis consistent with generally accepted accounting principles (GAAP). Annual budgets lapse at fiscal year end.
6. Adoption and amendments of all budgets used by the City are governed by Public Act 621, which was followed during the year ended June 30, 2006. The appropriations resolution is based on the projected expenditures budget of the department heads of the City. Any amendment to the original budget must meet the requirements of Public Act 621. Any revisions that alter the total expenditures of any fund must be approved by the City Council. The City Manager is authorized to transfer budgeted amounts within an activity subject to the condition that the total expenditures do not exceed the approved appropriations by activity. Supplemental appropriations were necessary during the year.

Budgets and Budgetary Accounting

Budgets for expenditures are adopted on an activity level basis in the General Fund and by function in the Special Revenue funds. Thus, expenditures may not legally exceed the budgeted amounts by activity for the General Fund and by function for the Special Revenue funds.

Cash and Cash Equivalents

For the purpose of the statement of cash flows, the City considers all highly liquid investments with an original maturity of three months or less when purchased to be cash equivalents.

Restricted Assets

Certain resources set aside for repayment of bonds and to meet bond covenants, are classified as restricted assets on the statement of net assets because their use is limited by applicable bond covenants.

Receivables

All receivables are recorded at their gross value and, where appropriate, are reduced by the estimated portion that is expected to be uncollectible. Special assessments receivable include \$71,552 which are expected to be collected in greater than one year.

CITY OF REED CITY

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2006

Due to/from Other Funds

During the course of its operations, the City has numerous transactions between funds to finance operations, to provide services, construct assets and service debt. To the extent that certain transactions between funds had not been paid or received as of fiscal year end, balances of interfund accounts receivable or payable have been recorded.

Capital Assets

Capital assets, which include property, plant, equipment, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items), are reported in the governmental and business-type activities columns in the government-wide financial statements. Capital assets are defined by the government as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of one year. Such assets are valued at cost where historical records are available and at an estimated historical cost where no historical records exist. Donated capital assets are valued at their estimated fair market value on the date received. The amount reported for infrastructure includes only assets added in 2003 and forward.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized. Improvements are capitalized and depreciated over the remaining useful lives of the related capital assets, as applicable.

No interest expense has been incurred or capitalized on capital assets reported in proprietary funds.

Depreciation on capital assets (including infrastructure), is computed using the straight-line method over the following estimated useful lives:

	<u>Years</u>
Land improvements	10-20
Buildings	20-50
Office furniture and equipment	5-15
Vehicles	5-10
Public domain infrastructure	10-50
System infrastructure	40-50

Deferred Revenue

Governmental funds report *deferred revenue* in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period or for resources that have been received, but not yet earned. At the end of the current fiscal year, the various components of *deferred revenue* reported in the governmental funds were as follows:

Special assessment (Maplewood Special Assessment Fund)	<u>\$71,552</u>
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CITY OF REED CITY

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2006

Long-Term Obligations

In the government-wide financial statements and proprietary fund types in the fund financial statements, the long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund type statement of net assets. For new bond issuances after the implementation of GASB Statement No. 34, bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the straight-line method which approximates the effective interest method. Bonds payable are reported net of the applicable bond premium or discount.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

Compensated Absences

Under contracts negotiated with employee groups, individual employees have a vested right to receive payments for unused vacation benefits under formulas and conditions specified in the contracts.

Accumulated vacation time of governmental funds is recorded on statement of net assets and not on the governmental fund balance sheets because it is not expected to be liquidated with expendable available financial resources. Amounts accumulated for proprietary funds have been evaluated and determined to be immaterial to the financial statements as a whole. Consequently, no portion of the liability is reported on the statements of net assets of the enterprise fund.

Property Taxes

City property taxes are attached as an enforceable lien on property as of July 1. Taxes are levied July 1 and are due without penalty on or before August 31. These summer tax bills include the City's own property taxes and taxes billed on behalf of the school district (State Education Tax) within the City limits. Real property taxes not collected as of March 1 are returned to the County for collection, which advances the City 100% for the delinquent real property taxes. Collection of delinquent personal property taxes remains the responsibility of the City Treasurer.

Property taxes levied in July of each year are recognized as revenue in that year.

Interfund Transactions

During the course of normal operations, the City has numerous transactions between funds, including expenditures and transfers of resources to provide services and to service debt. The accompanying financial statements generally reflect such transactions as transfers. Operating subsidies are also recorded as transfers.

CITY OF REED CITY

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2006

2. DEFICIT NET ASSETS

At June 30, 2006, the City had deficit net assets of \$611,435 in the Downtown Development Authority Component Unit as presented on the full accrual basis of accounting. However, no deficit exists in the individual funds presented on the modified accrual basis of accounting.

3. EXCESS OF EXPENDITURES OVER APPROPRIATIONS IN BUDGETARY FUNDS

During the year ended June 30, 2006 the City incurred expenditures in certain budgetary funds which were in excess of the amounts appropriated, as follows:

	<u>Total Appropriations</u>	<u>Amount of Expenditures</u>	<u>Budget Variance</u>
Park Commission Fund:			
Culture and recreation	\$14,600	\$14,930	\$330
Maplewood Special Assessment:			
Transfers out	30,225	30,244	19

4. CASH AND INVESTMENTS

Cash and investments consist of the following at June 30, 2006:

	<u>Primary Government</u>	<u>Component Units</u>	<u>Totals</u>
Statement of Net Assets			
Cash and cash equivalents	\$ 1,401,019	\$ 460,374	\$ 1,861,393
Restricted cash and cash equivalents	413,843	-	413,843
Statement of Fiduciary Net Assets			
Cash and cash equivalents	<u>13,887</u>	<u>-</u>	<u>13,887</u>
	<u>\$ 1,828,749</u>	<u>\$ 460,374</u>	<u>\$ 2,289,123</u>
Deposits and Investments			
Cash on hand			\$ 430
Bank deposits			991,994
Certificates of deposit			<u>1,296,699</u>
			<u>\$ 2,289,123</u>

CITY OF REED CITY

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2006

Deposits

Custodial Credit Risk – Deposits. Custodial credit risk is the risk that in the event of a bank failure, the City's deposits may not be returned. State law does not require, and the City does not have, a policy for deposit custodial credit risk. As of year end, \$2,138,522 of the City's bank balance of \$2,438,522 was exposed to custodial credit risk because it was uninsured and uncollateralized.

These deposits are in three (3) financial institutions located in Michigan in varying amounts. State policy limits the Treasurer's investing options to financial institutions located in Michigan. All accounts are in the name of the City and a specific fund or common account. They are recorded in City records at cost. Interest is recorded when earned.

Investments

The City chooses to disclose its investments by specifically identifying each. As of year end, the City had the following investments.

<u>Investment</u>	<u>Maturity</u>	<u>Fair Value</u>
Certificate of Deposit	< 1 year	\$783,417
Certificate of Deposit	1-5 years	513,282

Interest Rate Risk. State law limits the allowable investments and the maturities of some of the allowable investments as identified below in the Statutory Authority section. The City's investment policy does not have specific limits in excess of state law on investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. The maturity date for each investment is identified above for investments held at year end.

Statutory Authority

Act 217, PA 1982, authorizes the City to deposit and invest in:

- Bonds and other direct obligations of the United States or its agencies.
- Certificates of deposit, savings accounts, deposit accounts or depository receipts of a qualified financial institution.
- Commercial paper rated at the time of purchase within the two highest classifications established by not less than two standard rating services and that matures not more than 270 days after the date of purchase.
- Bankers acceptances of United States banks.
- Obligations of the State of Michigan and its political subdivisions that, at the time of purchase are rated as investment grade by at least one standard rating service.
- Mutual funds registered under the Investment Company Act of 1940 with the authority to purchase only investment vehicles that are legal for direct investment by a public corporation.
- External investment pools as authorized by Public Act 20 as amended through 12/31/97.

CITY OF REED CITY

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2006

5. INTERFUND RECEIVABLES AND PAYABLES

	Due From Other Funds	Due to Other Funds
General Fund	\$ -	\$37,049
Major Streets Fund	-	3,151
Local Streets Fund	-	1,812
Compensated Absences Internal Service Fund	42,012	-
	<u>\$42,012</u>	<u>\$42,012</u>

Interfund balances primarily reflect loans made from funds with cash and cash equivalents to those funds requiring temporary cash flow needs.

6. INTERFUND TRANSACTIONS

Transfers in and out for the year ended June 30, 2006 are as follows:

	Transfers Out			
	General Fund	Major Streets Fund	Nonmajor Governmental Funds	Total
Transfers in:				
General Fund	\$ -	\$ -	\$ 6,531	\$ 6,531
Major Streets Fund	-	-	22,222	22,222
Sewer & Water Enterprise Funds	-	-	2,000	2,000
Internal Service Fund	-	-	1,000	1,000
Nonmajor Governmental Funds	5,000	8,343	30,744	44,087
Total	<u>\$5,000</u>	<u>\$8,343</u>	<u>\$62,497</u>	<u>\$ 75,840</u>

Transfers are used to: (1) move unrestricted revenues collected in the General Fund to finance various programs accounted for in other funds in accordance with budgetary authorizations and (2) move revenues from the fund that is required to collect them to the fund that is required or allowed to expend them.

CITY OF REED CITY

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2006

7. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2006 was as follows:

	<u>Balance July 1, 2005</u>	<u>Additions</u>	<u>Dispositions</u>	<u>Balance June 30, 2006</u>
Governmental activities				
Capital assets, not being depreciated:				
Land	\$ 92,611	\$ 493	\$ -	\$ 93,104
Construction in progress	37,976	4,688	37,967	4,688
Total capital assets, not being depreciated	130,587	5,181	37,976	97,792
Capital assets, being depreciated:				
Land improvements	142,884	3,361	-	146,245
Buildings and improvements	1,449,197	370,462	-	1,819,659
Furniture and equipment	383,913	32,446	1,895	414,464
Motor vehicles	929,922	48,206	14,781	963,347
Infrastructure	487,759	214,084	-	701,843
Total capital assets, being depreciated	3,393,675	668,559	16,676	4,045,558
Less accumulated depreciation for:				
Land improvements	40,421	31,586	-	72,007
Buildings and improvements	157,267	20,206	-	177,473
Furniture and equipment	194,468	39,182	1,895	231,755
Motor vehicles	625,585	48,964	14,781	659,768
Infrastructure	17,390	1,442	-	18,832
Total accumulated depreciation	1,035,131	141,380	16,676	1,159,835
Net capital assets, being depreciated	2,358,544	527,179	-	2,885,723
Net governmental activities capital assets	<u>\$ 2,489,131</u>	<u>\$ 532,360</u>	<u>\$ 37,976</u>	<u>\$ 2,983,515</u>
Business-type activities				
Capital assets, not being depreciated:				
Land	\$ 30,305	\$ -	\$ -	\$ 30,305
Construction in process	23,898	119,219	-	143,117
Total capital assets, not being depreciated	54,203	119,219	-	173,422
Capital assets, being depreciated:				
Buildings	36,013	3,466	-	39,479
Equipment	348,584	30,769	19,409	359,944
Water system	1,159,836	248,092	-	1,407,928
Sewer system	10,952,622	15,391	-	10,968,013
Total capital assets, being depreciated	12,497,055	297,718	19,409	12,775,364

CITY OF REED CITY

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2006

	Balance July 1, 2005	Additions	Dispositions	Balance June 30, 2006
Less accumulated depreciation for:				
Buildings	\$ 26,476	\$ 2,586	\$ -	\$ 29,062
Equipment	180,960	20,883	19,409	182,434
Water system	699,642	44,650	-	744,292
Sewer system	2,978,449	268,921	-	3,247,370
Total accumulated depreciation	3,885,527	337,040	19,409	4,203,158
Net capital assets, being depreciated	8,611,528	(39,322)	-	8,572,206
Business-type activities capital assets, net	\$ 8,665,731	\$ 79,897	\$ -	\$ 8,745,628

Depreciation expense was charged to functions/programs of the primary government as follows:

Governmental activities:	
General government	\$ 11,023
Public safety	28,077
Recreation and culture	57,452
Public works	2,604
Capital assets held by the government's internal service funds are charged to the various functions based on their usage of the assets	42,224
Total depreciation expense – governmental activities	<u>\$141,380</u>

8. PENSION PLAN

Plan Description

The City participates in the Municipal Employees' Retirement System of Michigan (MERS), an agent multi-employer defined benefit pension plan providing retirement, death and disability benefits covering certain bargaining units. The System is administered by the MERS retirement board. Act No. 427 of the Public Acts of 1984, as amended, establishes and amends the benefit provisions of the participants in MERS. A publicly available financial report that includes financial statements and required supplementary information for MERS may be obtained by writing to the Municipal Employees Retirement System of Michigan, 1134 Municipal Way, Lansing, Michigan 48917 or by calling (800) 767-6377.

The City is required to contribute at an actuarially determined rate, which for the current year ranged from 18.18 to 31.36 percent. Employees are not required to contribute to the Plan. The contribution requirements of the City are established and may be amended by the MERS Retirement Board.

For the year ended June 30, 2006, the City's annual pension cost of \$198,134 for MERS was equal to the City's required and actual contributions. The required contribution was determined as part of the December 31, 2005 actuarial valuation using the entry age actuarial cost method. The actuarial assumptions included: (a) a rate of return on the investment of present and future assets of eight (8.0) percent; and (b) projected salary increases of four and one-half (4.5) percent per year compounded annually based on inflation, plus a percentage based on an age-related scale to reflect merit, longevity and promotional salary increases. The actuarial value of MERS assets was determined on the basis of a valuation method that assumes the fund earns the expected rate of return and includes an adjustment to reflect fair value. The City's unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on an open basis. The remaining amortization period at December 31, 2005, the date of the latest actuarial valuation, was 30 years.

CITY OF REED CITY

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2006

Trend Information

<u>Year Ended</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation</u>
2004	\$194,722	100%	\$ -
2005	193,417	100%	-
2006	198,134	100%	-

Schedule of Funding Progress

<u>Actuarial Valuation Date</u>	<u>Actuarial Value of Assets (a)</u>	<u>Actuarial Accrued Liability (AAL) Entry Age (b)</u>	<u>Unfunded AAL (UAAL) (b-a)</u>	<u>Funded Ratio Total</u>	<u>Covered Payroll (c)</u>	<u>UAAL as a Percentage of Covered Payroll ((b-a)/c)</u>
12/31/2003	\$2,321,349	\$3,538,040	\$1,216,691	66%	\$903,856	135%
12/31/2004	2,493,140	3,714,628	1,221,488	67%	906,426	135%
12/31/2005	2,685,041	3,846,839	1,161,798	70%	932,025	125%

9. LONG-TERM DEBT

The following is a summary of debt transactions of the City for the year ended June 30, 2006:

	<u>Balance July 1, 2005</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance June 30, 2006</u>	<u>Due Within One Year</u>
Governmental activities					
Internal Service Fund:					
Equipment installment note due in annual installments of \$6,950 through October 2005; interest at 4.95%.	\$ 6,950	\$ -	\$ (6,950)	\$ -	\$ -
Governmental Funds:					
\$225,000 Special Assessment Bonds of 2002 due in annual installments of \$20,000 to \$25,000 through September 2011; average interest at 3.994%.	165,000	-	(20,000)	145,000	20,000
\$575,000 Fire Station General Obligation Bonds of 2002 due in annual installments of \$9,000 to \$37,000 through May 2032; interest at 4.625%.	549,000	-	(10,000)	539,000	10,000
Subtotal-installment debt	720,950	-	(36,950)	684,000	30,000
Long-term compensated absences	40,474	-	(5,448)	35,026	-
Total governmental activities	<u>\$ 761,424</u>	<u>\$ -</u>	<u>\$ (42,398)</u>	<u>\$ 719,026</u>	<u>\$ 30,000</u>

CITY OF REED CITY

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2006

	Balance July 1, 2005	Additions	Deletions	Balance June 30, 2006	Due Within One Year
<i>Business-type activities</i>					
Enterprise Fund					
\$1,105,000 Water Supply/Wastewater System Revenue Bonds of 1998 due in annual installments of \$40,000 to \$85,000 through November 2019; interest at rates varying from 4.3% to 5.2%.	\$ 890,000	\$ -	\$ (40,000)	\$ 850,000	\$ 45,000
\$435,000 Water Supply and Wastewater System Revenue Refunding Bonds of 2004 due in annual installments of \$65,000 to \$80,000 through July 2010; interest at rates varying from 1.87% to 3.84%.	365,000	-	(65,000)	300,000	-
Equipment installment note due in semi-annual installments of approximately \$20,200 including interest through August 2013; interest at 5.28%.	273,982	-	(26,298)	247,684	27,705
Total business-type activities	<u>\$1,528,982</u>	<u>\$ -</u>	<u>\$ (131,298)</u>	<u>\$1,397,684</u>	<u>\$ 72,705</u>
<i>Component unit</i>					
\$1,300,000 Downtown Development Revenue Bonds of 1998 due in annual installments of \$25,000 to \$250,000 through 2017; interest rates varying from 9.25% to 5.75%.	\$1,140,000	\$ -	\$ (40,000)	\$1,100,000	\$ 40,000

For the governmental activities, long-term compensated absences are generally liquidated by the general fund.

The annual requirements to amortize all debt outstanding (excluding long-term compensated absences) as of June 30, 2006 are as follows:

Year Ending June 30,	Governmental Activities		Business-type Activities		Component Unit	
	Principal	Interest	Principal	Interest	Principal	Interest
2007	\$ 30,000	\$ 29,874	\$ 72,705	\$ 54,288	\$ 40,000	\$ 62,750
2008	36,000	28,654	144,188	59,992	70,000	60,650
2009	37,000	27,227	150,749	54,106	75,000	56,925
2010	37,000	25,713	157,394	47,660	75,000	52,613
2011	38,000	23,944	164,127	40,666	80,000	48,300
2012-2016	98,000	104,986	398,521	128,673	510,000	163,589
2017-2021	95,000	86,026	310,000	33,540	250,000	14,375
2022-2026	121,000	61,744	-	-	-	-
2027-2031	155,000	30,803	-	-	-	-
2032	37,000	1,711	-	-	-	-
Total	\$684,000	\$ 420,682	\$1,397,684	\$418,925	\$1,100,000	\$ 459,202

CITY OF REED CITY

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2006

10. RISK MANAGEMENT

The City is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; and natural disasters for which the government carries commercial insurance. The City carries commercial health, medical, and optical insurance. Statement No. 10 of the Governmental Accounting Standards Board requires that a liability for claims be reported if it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Settled claims have not exceeded commercial insurance coverage in any of the past three fiscal years.

11. CONCENTRATIONS

The City has a significant economic dependence on a local corporation that is a major employer, taxpayer, and user of water and sewer services. The following is the percentage of taxes and utilities paid by the corporation:

	Amount	Percent of Total
Property taxes	\$304,195	34%
Water and sewer billing	927,224	64%
Water and sewer accounts receivable	88,687	50%

12. CONTINGENT LIABILITY

Wastewater Treatment Plant

The City owns a parcel of land that is used for its wastewater treatment plant. The parcel was previously owned by Koppers Company which operated a creosote plant treating poles and railroad ties. The Department of Natural Resources has notified Koppers and the City that a previous clean-up of the site is not sufficient and a new hydro geological study must be completed. The Department of Natural Resources claims that the City may be a possible responsible party because it presently owns the property and must be involved in the study and remedial action. Creosote leaking into a river is being purged and treated in the City's wastewater treatment plant. Total costs of the clean-up could be substantial. The City of Reed City and Beazer East, Inc. (the successor to Koppers) have entered into an agreement regarding certain cost sharing which requires, among other things, that the City is to treat water from the wells. There has not been a determination of responsible parties, the cost of the project, or whether the costs will be covered by insurance. Based on these factors, no provision for the contingency is included in the financial statements.

The City has also been notified by the Department of Environmental Quality of certain violations at its wastewater treatment plant. The potential cost to the City as a result of the violations is unknown.

Landfill

From September 17, 1968 until March 8, 1985, the City operated a landfill, which is now privately owned and operated. The City, Richmond Sanitary Landfill, Inc. and the Department of Natural Resources entered into a Consent Agreement which outlines certain obligations of the parties regarding the capping of the landfill. The majority of the City's requirements under the Consent Agreement have been completed. It is impossible to determine the financial obligation that the City of Reed City may ultimately have regarding the landfill until further studies and tests are done. If there are contamination problems at the landfill and the City is held liable, the cost to the City could be significant.

CITY OF REED CITY

NOTES TO FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2006

Downtown Development Authority

The Downtown Development Authority has entered into an agreement to pay \$100,000 per year for ten years beginning in the year ended June 30, 2005, for their portion of a force main project. The payment is contingent on a business in the City maintaining their current production capacity.

13. PRIOR PERIOD ADJUSTMENT

Beginning net assets of the Sewer & Water Enterprise Fund and business-type activities were increased by \$23,898 to properly account for construction in progress at June 30, 2005.

14. COMMITMENTS

The City has approximately \$1,400,000 committed under contracts at June 30, 2006 related to water tower construction and improvements to water mains. Accordingly these costs were financed through the sale of revenue bonds which occurred prior to June 30, 2006. As of June 30, 2006, no draws were taken on the bonds and therefore no liability is presented in the Statement of Net Assets.

The City also has approximately \$275,000 committed under contract for the purchase of a fire truck.

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CITY OF REED CITY

Combining Balance Sheets Nonmajor Governmental Funds

June 30, 2006

	Special Revenue					
	Local Streets	Law Enforcement Training	Library	Fire Equipment Replacement	Maplewood Special Assessment	Emergency Contingency
Assets						
Cash and cash equivalents	\$ 20,110	\$ 2,608	\$ 134,099	\$ 74,515	\$ 23	\$ 258,155
Accounts receivable, net of allowance	-	-	121	-	-	-
Special assessments receivable	-	-	-	-	88,955	-
Due from other governmental units	7,783	-	-	-	-	-
Prepaid items	296	-	201	-	-	-
Total assets	<u>\$ 28,189</u>	<u>\$ 2,608</u>	<u>\$ 134,421</u>	<u>\$ 74,515</u>	<u>\$ 88,978</u>	<u>\$ 258,155</u>
Liabilities and fund balances						
Liabilities						
Accounts payable	\$ 1,406	\$ -	\$ 964	\$ 2,125	\$ -	\$ -
Accrued liabilities	784	-	1,218	-	-	-
Due to other funds	1,812	-	-	-	-	-
Deferred revenue	-	-	-	-	71,552	-
Total liabilities	<u>4,002</u>	<u>-</u>	<u>2,182</u>	<u>2,125</u>	<u>71,552</u>	<u>-</u>
Fund balances						
Reserved for :						
Prepaid items	296	-	201	-	-	-
Perpetual care	-	-	-	-	-	-
Unreserved:						
Designated for subsequent year expenditures	18,025	970	22,620	-	-	-
Undesignated	5,866	1,638	109,418	72,390	17,426	258,155
Total fund balances	<u>24,187</u>	<u>2,608</u>	<u>132,239</u>	<u>72,390</u>	<u>17,426</u>	<u>258,155</u>
Total liabilities and fund balances	<u>\$ 28,189</u>	<u>\$ 2,608</u>	<u>\$ 134,421</u>	<u>\$ 74,515</u>	<u>\$ 88,978</u>	<u>\$ 258,155</u>

		Debt Service		Capital Projects		Permanent	Total
Park Commission	Police Reserve Officer	Special Assessment Bond	Fire Station	Equipment and Replacement	Parks Improvement	Cemetery Perpetual Care	
\$ 13,393	\$ 385	\$ 60,455	\$ 32,884	\$ 4,303	\$ 23,453	\$ 44,346	\$ 668,729
-	-	-	216	-	-	-	337
-	-	-	-	-	-	-	88,955
-	-	-	-	-	-	-	7,783
714	-	-	-	-	-	-	1,211
<u>\$ 14,107</u>	<u>\$ 385</u>	<u>\$ 60,455</u>	<u>\$ 33,100</u>	<u>\$ 4,303</u>	<u>\$ 23,453</u>	<u>\$ 44,346</u>	<u>\$ 767,015</u>
\$ 160	\$ -	\$ -	\$ -	\$ -	\$ 6,600	\$ -	\$ 11,255
-	-	-	-	-	-	-	2,002
-	-	-	-	-	-	-	1,812
-	-	-	-	-	-	-	71,552
<u>160</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>6,600</u>	<u>-</u>	<u>86,621</u>
714	-	-	-	-	-	-	1,211
-	-	-	-	-	-	33,750	33,750
500	-	-	-	-	-	-	42,115
<u>12,733</u>	<u>385</u>	<u>60,455</u>	<u>33,100</u>	<u>4,303</u>	<u>16,853</u>	<u>10,596</u>	<u>603,318</u>
<u>13,947</u>	<u>385</u>	<u>60,455</u>	<u>33,100</u>	<u>4,303</u>	<u>16,853</u>	<u>44,346</u>	<u>680,394</u>
<u>\$ 14,107</u>	<u>\$ 385</u>	<u>\$ 60,455</u>	<u>\$ 33,100</u>	<u>\$ 4,303</u>	<u>\$ 23,453</u>	<u>\$ 44,346</u>	<u>\$ 767,015</u>

CITY OF REED CITY

Combining Statement of Revenues, Expenditures and Changes in Fund Balances Nonmajor Governmental Funds

For the Year Ended June 30, 2006

	Special Revenue					
	Local Streets	Law Enforcement Training	Library	Fire Equipment Replacement	Maplewood Special Assessment	Emergency Contingency
Revenues						
Property taxes	\$ -	\$ -	\$ 32,014	\$ -		\$ -
Special assessments	-		-	-	22,616	
Intergovernmental:						
State	55,933	-	-	-		-
Local	-	-	-	20,000		-
Miscellaneous	1,284	997	90,639	1,898	6,651	8,015
Total revenues	57,217	997	122,653	21,898	29,267	8,015
Expenditures						
Current:						
General government	-	-	-	-	-	-
Public safety	-	-	-	-	-	-
Highways and streets	90,194	-	-	-	-	-
Culture and recreation	-	-	99,282	-	-	-
Debt service:						
Principal	-	-	-	-	-	-
Interest	-	-	-	-	-	-
Capital outlay	-	-	17,960	2,604	-	-
Total expenditures	90,194	-	117,242	2,604	-	-
Revenues over (under) expenditures	(32,977)	997	5,411	19,294	29,267	8,015
Other financing sources (uses)						
Transfers in	21,222	-	-	6,531	-	-
Transfers out	(8,843)	-	-	-	(30,244)	(5,000)
Total other financing sources (uses)	12,379	-	-	6,531	(30,244)	(5,000)
Net change in fund balances	(20,598)	997	5,411	25,825	(977)	3,015
Fund balances, beginning of year	44,785	1,611	126,828	46,565	18,403	255,140
Fund balances, end of year	\$ 24,187	\$ 2,608	\$ 132,239	\$ 72,390	\$ 17,426	\$ 258,155

Park Commission	Police Reserve Officer	Debt Service		Capital Projects		Permanent Cemetery Perpetual Care	Total
		Special Assessment Bond	Fire Station	Equipment and Replacement	Parks Improvement		
\$ -	\$ -	\$ -	\$ 33,025	\$ -	\$ -	\$ -	\$ 65,039
							22,616
-	-	-	-	-	-	-	55,933
7,000	-	-	-	-	-	-	27,000
8,189	1,388	67	1,239	138	4,073	1,799	126,377
15,189	1,388	67	34,264	138	4,073	1,799	296,965
-	-	-	-	-	-	391	391
-	1,059	-	-	-	-	-	1,059
-	-	-	-	-	-	-	90,194
14,930	-	-	-	-	-	-	114,212
-	-	20,000	10,000	-	-	-	30,000
-	-	6,270	25,391	-	-	-	31,661
-	-	-	-	4,295	10,108	-	34,967
14,930	1,059	26,270	35,391	4,295	10,108	391	302,484
259	329	(26,203)	(1,127)	(4,157)	(6,035)	1,408	(5,519)
-	-	30,244	-	4,500	-	-	62,497
-	-	-	-	-	-	-	(44,087)
-	-	30,244	-	4,500	-	-	18,410
259	329	4,041	(1,127)	343	(6,035)	1,408	12,891
13,688	56	56,414	34,227	3,960	22,888	42,938	667,503
\$ 13,947	\$ 385	\$ 60,455	\$ 33,100	\$ 4,303	\$ 16,853	\$ 44,346	\$ 680,394

CITY OF REED CITY

**Schedule of Revenues, Expenditures
and Changes in Fund Balance
Budget and Actual
Local Streets Fund**

For the Year Ended June 30, 2006

	Original Budget	Amended Budget	Actual	Actual Over (Under) Budget
Revenues				
Intergovernmental revenues:				
State	\$ 64,750	\$ 64,750	\$ 55,933	\$ (8,817)
Miscellaneous	1,100	1,100	1,284	184
Total revenues	65,850	65,850	57,217	(8,633)
Expenditures				
Highways and streets	93,018	93,018	90,194	(2,824)
Revenues over (under) expenditures	(27,168)	(27,168)	(32,977)	(5,809)
Other financing sources (uses)				
Transfers in	21,222	21,222	21,222	-
Transfers (out)	(10,250)	(10,250)	(8,843)	1,407
Total other financing sources (uses)	10,972	10,972	12,379	1,407
Net change in fund balance	(16,196)	(16,196)	(20,598)	(4,402)
Fund balance, beginning of year	44,785	44,785	44,785	-
Fund balance, end of year	\$ 28,589	\$ 28,589	\$ 24,187	\$ (4,402)

CITY OF REED CITY

Schedule of Revenues, Expenditures and Changes in Fund Balance Budget and Actual Law Enforcement Training

For the Year Ended June 30, 2006

	Original Budget	Amended Budget	Actual	Actual Over (Under) Budget
Revenues				
Miscellaneous	\$ -	\$ 987	\$ 997	\$ 10
Other financing sources (uses)				
Transfers (out)	-	(1,987)	-	1,987
Net change in fund balance	-	(1,000)	997	1,997
Fund balance, beginning of year	1,611	1,611	1,611	-
Fund balance, end of year	<u>\$ 1,611</u>	<u>\$ 611</u>	<u>\$ 2,608</u>	<u>\$ 1,997</u>

CITY OF REED CITY

Schedule of Revenues, Expenditures and Changes in Fund Balance Budget and Actual Library Fund

For the Year Ended June 30, 2006

	Original Budget	Amended Budget	Actual	Actual Over (Under) Budget
Revenues				
Property taxes	\$ 31,825	\$ 31,825	\$ 32,014	\$ 189
Miscellaneous	84,100	85,600	90,639	5,039
Total revenues	115,925	117,425	122,653	5,228
Expenditures				
Culture and recreation	110,049	111,499	99,282	(12,217)
Capital outlay	25,000	25,050	17,960	(7,090)
Total expenditures	135,049	136,549	117,242	(19,307)
Net change in fund balance	(19,124)	(19,124)	5,411	24,535
Fund balance, beginning of year	126,828	126,828	126,828	-
Fund balance, end of year	<u>\$ 107,704</u>	<u>\$ 107,704</u>	<u>\$ 132,239</u>	<u>\$ 24,535</u>

CITY OF REED CITY

Schedule of Revenues, Expenditures and Changes in Fund Balance Budget and Actual Fire Equipment Replacement

For the Year Ended June 30, 2006

	Original Budget	Amended Budget	Actual	Actual Over (Under) Budget
Revenues				
Intergovernmental:				
Local	\$ -	\$ 20,000	\$ 20,000	\$ -
Miscellaneous	450	450	1,898	1,448
Total revenues	450	20,450	21,898	1,448
Expenditures				
Capital outlay	-	34,450	2,604	(31,846)
Net change in fund balances	450	(14,000)	19,294	33,294
Other financing sources (uses)				
Transfers in	-	-	6,531	6,531
Transfers (out)	(19,450)	(5,000)	-	5,000
Total other financing sources (uses)	(19,450)	(5,000)	6,531	11,531
Net change in fund balance	(19,000)	(19,000)	25,825	44,825
Fund balance, beginning of year	46,565	46,565	46,565	-
Fund balance, end of year	<u>\$ 27,565</u>	<u>\$ 27,565</u>	<u>\$ 72,390</u>	<u>\$ 44,825</u>

CITY OF REED CITY

Statement of Revenues, Expenditures and Changes in Fund Balance Budget and Actual Maplewood Special Assessment

For the Year Ended June 30, 2006

	Original Budget	Amended Budget	Actual	Actual Over (Under) Budget
Revenues				
Special assessments	\$ 18,402	\$ 23,615	\$ 22,616	\$ (999)
Miscellaneous	6,610	6,610	6,651	41
Total revenues	25,012	30,225	29,267	(958)
Other financing sources (uses)				
Transfers (out)	(25,012)	(30,225)	(30,244)	(19)
Net change in fund balance	-	-	(977)	(977)
Fund balance, beginning of year	18,403	18,403	18,403	-
Fund balance, end of year	<u>\$ 18,403</u>	<u>\$ 18,403</u>	<u>\$ 17,426</u>	<u>\$ (977)</u>

CITY OF REED CITY

Schedule of Revenues, Expenditures and Changes in Fund Balance Budget and Actual Emergency Contingency

For the Year Ended June 30, 2006

	Original Budget	Amended Budget	Actual	Actual Over (Under) Budget
Revenues				
Miscellaneous	\$ 5,000	\$ 5,000	\$ 8,015	\$ 3,015
Expenditures				
General government	-	-	-	-
Revenues over (under) expenditures	5,000	5,000	8,015	3,015
Other financing sources (uses)				
Transfers (out)	(5,000)	(5,000)	(5,000)	-
Net change in fund balance	-	-	3,015	3,015
Fund balance, beginning of year	255,140	255,140	255,140	-
Fund balance, end of year	<u>\$ 255,140</u>	<u>\$ 255,140</u>	<u>\$ 258,155</u>	<u>\$ 3,015</u>

CITY OF REED CITY

Schedule of Revenues, Expenditures and Changes in Fund Balance Budget and Actual Park Commission

For the Year Ended June 30, 2006

	Original Budget	Amended Budget	Actual	Actual Over (Under) Budget
Revenues				
Intergovernmental revenues:				
Local	\$ 7,000	\$ 7,000	\$ 7,000	\$ -
Miscellaneous	7,000	7,600	8,189	589
Total revenues	14,000	14,600	15,189	589
Expenditures				
Culture and recreation	14,000	14,600	14,930	330
Revenues over (under) expenditures	-	-	259	259
Fund balance, beginning of year	13,688	13,688	13,688	-
Fund balance, end of year	<u>\$ 13,688</u>	<u>\$ 13,688</u>	<u>\$ 13,947</u>	<u>\$ 259</u>

CITY OF REED CITY

Schedule of Revenues, Expenditures and Changes in Fund Balance Budget and Actual Police Reserve Officer Fund

For the Year Ended June 30, 2006

	Original Budget	Amended Budget	Actual	Actual Over (Under) Budget
Revenues				
Miscellaneous	\$ -	\$ 1,375	\$ 1,388	\$ 13
Expenditures				
Public safety	-	1,375	1,059	(316)
Net change in fund balance	-	-	329	329
Fund balance, beginning of year	56	56	56	-
Fund balance, end of year	<u>\$ 56</u>	<u>\$ 56</u>	<u>\$ 385</u>	<u>\$ 329</u>

CITY OF REED CITY

Combining Statement of Net Assets Internal Service Funds

June 30, 2006

	Compensated Absences Fund	Motor Pool Fund	Total
Assets			
Current assets:			
Cash and cash equivalents	\$ -	\$ 81,696	\$ 81,696
Due from other funds	42,012	-	42,012
Prepaid items	-	410	410
Total current assets	42,012	82,106	124,118
Non-current assets:			
Capital assets:			
Machinery and equipment	-	721,547	721,547
Less: accumulated depreciation	-	(462,765)	(462,765)
Total	-	258,782	258,782
Total assets	42,012	340,888	382,900
Liabilities			
Current liabilities:			
Accounts payable	-	4,968	4,968
Accrued liabilities	42,012	7,478	49,490
Total liabilities	42,012	12,446	54,458
Net assets			
Invested in capital assets, net of related debt	-	258,782	258,782
Unrestricted	-	69,660	69,660
Total net assets	\$ -	\$ 328,442	\$ 328,442

CITY OF REED CITY

Combining Statement of Revenues, Expenses and Changes in Net Assets Internal Service Funds

For the Year Ended June 30, 2006

	Compensated Absences Fund	Motor Pool Fund	Total
Operating revenues			
Charges for services	\$ -	\$ 178,087	\$ 178,087
Miscellaneous	-	856	856
Total operating revenues	-	178,943	178,943
Operating expenses			
Personnel services	-	56,262	56,262
Contractual services	-	15,728	15,728
Materials and supplies	-	33,280	33,280
Utilities	-	9,952	9,952
Repairs and maintenance	-	20,524	20,524
Depreciation and amortization	-	42,224	42,224
Total operating expenses	-	177,970	177,970
Operating income	-	973	973
Non operating revenues (expenses)			
Gain on sale of capital assets	-	1,031	1,031
Interest income	-	2,631	2,631
Interest expense	-	(81)	(81)
Total non operating revenues (expenses)	-	3,581	3,581
Net income before transfers	-	4,554	4,554
Transfers out	-	(1,000)	(1,000)
Change in net assets	-	3,554	3,554
Net assets, beginning of year	-	324,888	324,888
Net assets, end of year	\$ -	\$ 328,442	\$ 328,442

CITY OF REED CITY

**Combining Statement of Cash Flows
Internal Service Funds**

For the Year Ended June 30, 2006

	Compensated Absences Fund	Motor Pool Fund	Total
Cash flows from operating activities			
Receipts from interfund services provided	\$ 42,012	\$ 178,943	\$ 220,955
Payments to suppliers	-	(77,326)	(77,326)
Payments to employees	-	(56,498)	(56,498)
Net cash provided by operating activities	<u>42,012</u>	<u>45,119</u>	<u>87,131</u>
Cash flows from non-capital financing activities			
Amounts lent to other funds	(42,012)	-	(42,012)
Transfers (out)	-	(1,000)	(1,000)
Net cash provided by (used in) non-capital financing activities	<u>(42,012)</u>	<u>(1,000)</u>	<u>(43,012)</u>
Cash flows from capital and related financing activities			
Acquisition of capital assets	-	(46,506)	(46,506)
Proceeds from sale of capital assets	-	1,031	1,031
Principal paid on bonds	-	(6,950)	(6,950)
Interest and fiscal charges paid	-	(81)	(81)
Net cash provided by (used in) capital and related financing activities	<u>-</u>	<u>(52,506)</u>	<u>(52,506)</u>
Cash flows from investing activities			
Interest earned on investments	-	2,631	2,631
Net increase (decrease) in cash and cash equivalents	-	(5,756)	(5,756)
Cash and cash equivalents, beginning of year	-	87,452	87,452
Cash and cash equivalents, end of year	<u>\$ -</u>	<u>\$ 81,696</u>	<u>\$ 81,696</u>
Cash flows from operating activities			
Operating income	\$ -	\$ 973	\$ 973
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation and amortization	-	42,224	42,224
Changes in operating assets and liabilities which provided (used) cash:			
Prepaid expenses	-	(48)	(48)
Accounts payable	-	2,206	2,206
Accrued liabilities	42,012	(236)	41,776
Net cash provided by operating activities	<u>\$ 42,012</u>	<u>\$ 45,119</u>	<u>\$ 87,131</u>

CITY OF REED CITY

**Fiduciary Funds
Combining Balance Sheet**

June 30, 2006

	Tax Collection	Payroll	Rails to Trails	Reed City Housing Commission	Osceola Foundation	Totals
Assets						
Cash and cash equivalents	\$ 1,034	\$ 745	\$ 1,064	\$ -	\$ 11,044	\$ 13,887
Liabilities						
Accounts payable	\$ 21	\$ -	\$ 722	\$ -	\$ 552	\$ 1,295
Due to other governmental units	1,013	745	-	-	-	1,758
Deposits held for others	-	-	342	-	10,492	10,834
Total liabilities	\$ 1,034	\$ 745	\$ 1,064	\$ -	\$ 11,044	\$ 13,887

CITY OF REED CITY

**Balance Sheet/Statement of Net Assets
Downtown Development Authority**

June 30, 2006

	General Operating Fund	Debt Service	Capital Projects	Adjustments	Statement of Net Assets
Assets					
Cash and cash equivalents	\$ 161,865	\$ 135,151	\$ 163,358	\$ -	\$ 460,374
Accounts receivable	35,816	-	-	-	35,816
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Total assets	\$ 197,681	\$ 135,151	\$ 163,358	-	496,190
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Liabilities and fund balance/net assets					
Liabilities					
Accounts payable	\$ -	\$ 300	\$ 2,305	\$ -	\$ 2,605
Deferred revenue	34,455	-	-	(34,455)	-
Accrued interest	-	-	-	5,020	5,020
Bond payable	-	-	-	1,100,000	1,100,000
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Total liabilities	34,455	300	2,305	1,070,565	1,107,625
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Fund balance					
Undesignated	163,226	134,851	161,053	(459,130)	-
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
Total liabilities and fund balance	\$ 197,681	\$ 135,151	\$ 163,358		
	<hr/>	<hr/>	<hr/>		
Net assets					
Unrestricted (deficit)				\$ (611,435)	\$ (611,435)
				<hr/>	<hr/>

CITY OF REED CITY

**Statement of Revenues, Expenditures
and Changes in Fund Balances/Net Assets
Downtown Development Authority**

For the Year Ended June 30, 2006

	General Operating Fund	Debt Service	Capital Projects	Adjustments	Statement of Net Assets
Revenues					
Taxes	\$ 551,785	\$ -	\$ -	\$ -	\$ 551,785
Miscellaneous	14,605	6,303	3,500	(545)	23,863
Total revenues	566,390	6,303	3,500	(545)	575,648
Expenditures/expenses					
Current:					
General government	35,000	-	753,197	(35,000)	753,197
Debt service:					
Principal retirement	-	40,000	-	(40,000)	-
Interest and fiscal charges	-	65,150	-	(78)	65,072
Total expenditures/expenses	35,000	105,150	753,197	(75,078)	818,269
Revenues over (under) expenditures	531,390	(98,847)	(749,697)	74,533	(242,621)
Other financing sources (uses)					
Transfers in	-	102,031	910,750	(1,012,781)	-
Transfers (out)	(1,012,781)	-	-	1,012,781	-
Total other financing sources (uses)	(1,012,781)	102,031	910,750	-	-
Net change in fund balances	(481,391)	3,184	161,053	317,154	
Change in net assets				(242,621)	(242,621)
Fund balances/net assets (deficit), beginning of year	644,617	131,667	-	(1,145,098)	(368,814)
Fund balances/net assets (deficit), end of year	\$ 163,226	\$ 134,851	\$ 161,053	\$ (1,070,565)	\$ (611,435)



REHMANN ROBSON

Certified Public Accountants

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**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL
OVER FINANCIAL REPORTING AND ON COMPLIANCE
AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL
STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

August 25, 2006

Honorable Mayor and
Members of the City Council
City of Reed City, Michigan

We have audited the financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the City of Reed City, Michigan, as of and for the year ended June 30, 2006, and have issued our report thereon dated August 25, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City of Reed City, Michigan's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of Reed City, Michigan's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the City Council, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

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